

REPORT OF EXAMINATION
MUTUAL OF ENUMCLAW INSURANCE
COMPANY

Enumclaw, Washington

December 31, 1999



States Participating:
Washington
Utah

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that I have reviewed the attached Report of Examination of the financial condition and affairs of MUTUAL OF ENUMCLAW INSURANCE COMPANY of Enumclaw, Washington, as of December 31, 1999.

Patrick H. McNaughton
Chief Examiner

Date

MUTUAL OF ENUMCLAW INSURANCE COMPANY
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Seattle, Washington
June 29, 2001

The Honorable Kathleen Sebilus
Chairman, NAIC Financial Condition Executive (EX) Committee
Commissioner, Kansas Insurance Department
420 SW 9th Street
Topeka, KS 66612-1678

The Honorable Bob Lohr
NAIC Secretary, Western Zone
Director, Alaska Division of Insurance
3601 C Street, Suite 1324
Anchorage, AK 99503-5948

The Honorable Mike Kreidler
Insurance Commissioner, State of Washington
Insurance Building, PO Box 40255
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.03 of the Revised Code of Washington (RCW), an Association Examination was made of the corporate affairs and financial records of the

MUTUAL OF ENUMCLAW INSURANCE COMPANY
of
Enumclaw, Washington

hereinafter referred to as the "Company", at its home office located at 1460 Wells Street, Enumclaw, Washington 98022. The following report on examination is respectfully submitted showing the condition of the Company as of December 31, 1999.

SCOPE OF EXAMINATION

As required by RCW 48.03.010, the examination covered the five-year period from January 1, 1995 through December 31, 1999. On August 28, 2000, an Association Examination was called to begin on October 30, 2000. Insurance examiners from the states of Washington and Utah conducted the current examination.

The examination was conducted in accordance with the laws and regulations of the state of Washington contained in Chapter 48 RCW and the Washington Administrative Code (WAC) 284 and the examination procedures prescribed by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiner's Handbook.

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Corporate records and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. Comments on any adverse findings that are applicable to the current examination are included in the "Instructions" and the "Comments and Recommendations" sections of this report.

INSTRUCTIONS

The following summarizes the instructions provided to the Company:

1. **Bonds** - One bond was not filed with the Securities Valuation Office of the NAIC. The Company did not list on Schedule D, Parts 4 and 5 of the 1999 Annual Statement the Name of Purchaser on Securities Sold. The Company did not use the trade date for the date of Purchase or Disposal of securities. The Company is instructed to file all securities as required by the NAIC and pursuant to WAC 284-07-050(2) and ensure proper annual statement reporting in accordance with RCW 48.05.250. (See "Notes and Comments to Financial Statements" #1, Page 20)

The Company's Safekeeping Agreement did not meet the minimum standards established by the NAIC concerning the custodian's indemnification of the insurance company for any loss of securities in the custodian's possession. The Company is instructed to amend the agreement to include this standard as required by the NAIC and in compliance with WAC 284-07-050(2). (See "Notes and Comments to Financial Statements" #1, Page 20)

2. **Preferred stocks** - The Company did not value two preferred stocks in accordance with the NAIC, RCW 48.05.280, and WAC 284-07-050(2). The Company is instructed to comply with the referenced statutes. These securities were kept at a broker custodian. This is in non-compliance with the NAIC standard requiring securities to be held in the custody of a bank, trust company, or security depository. The Company is instructed to comply with WAC 284-07-050(2). (See "Notes and Comments to Financial Statements" #2, Page 20)

3. **Common stocks** - The Company's Safekeeping Agreement did not meet the minimum standards established by the NAIC concerning the custodian's indemnification of the insurance company for any loss of securities in the custodian's possession. The Company is instructed to amend the agreement to include the standard as required by the NAIC and in compliance with WAC 284-07-050(2). (See "Other Agreements", Page 9)

These securities were kept at a broker custodian. This is in non-compliance with the NAIC standard requiring securities to be held in the custody of a bank, trust company, or security depository. The Company is instructed to comply with WAC 284-07-050(2). (See "Notes and Comments to Financial Statements" #3, Page 20)

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COMMENTS AND RECOMMENDATIONS

The following summarizes the comments and recommendations instructions provided to the Company:

1. **Uncollected Premiums/Unallocated Income** - The Company did not maintain a listing of the inventory of uncollected premiums at year-end. This did not meet the requirement to facilitate the examination of this account; however, alternative examination methods were used to satisfy requirements. Errors discovered in the analysis of this balance were immaterial and no examination adjustment was recommended. It is recommended that Company's automated systems and software be updated and integrated to provide accurate and appropriate historical data to meet statutory reporting requirements and be available for subsequent examination.

In addition, in order to recognize cash receipts that could not be offset to the applicable accounts receivable sub-accounts for financial statement purposes, the Company makes a monthly adjusting entry to record a liability for "Unallocated Income". Since cash has already been recorded by reducing the accounts receivable control account, the adjusting entry restores the receivable to its original balance in order to set up the presumed liability. Consequently, the inadvertent effect is to duplicate the asset recognition by the amount of the cash receipts. Although this practice has no surplus change, and since system constraints preclude any alternative correction, the optimal solution would be to cease making this entry until the system is enhanced. It is recommended that Company's automated systems and software be updated and integrated to provide accurate and appropriate accounting entries to meet statutory reporting requirements.

2. **Other Expenses** – In the prior examination, a reference was made to the Company that the methodology for accruing "Other Expenses" was inadequate and that management was advised to improve it. During this examination, the examiners found that the methodology was not changed and the resulting under-accrual for 1999 was \$177,210.

It is recommended that the Company improve its accrual methodology and that disbursements subsequent to year-end be monitored for as long as possible and expenditures relating to the prior year be identified for accrual in the final closing trial balance.

3. **Drafts Outstanding** – The Company has improperly classified its outstanding checks as of December 31, 1999 as outstanding drafts. While there is no effect on the Company's surplus, it is recommended that the Company reclassify these outstanding checks as a reduction of cash accounts. During the examination, it was noted that the Company did reclassify the outstanding checks as a reduction to cash in its 2000 Annual Statement.

4. **Salvage and Subrogation** – The examination testing of "Salvage and Subrogation" revealed that recoveries on homeowners' policy losses were incorrectly classified to another line of business, probably to auto. Although the amount involved was

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immaterial for examination purposes, it does distort the loss development data used for statutory and management reporting purposes and the examiners recommended that it should be corrected.

5. **IBNR** – In order to match industry's loss experience and prevailing IBNR accrual practices, the Company reduced its IBNR reserve from 3.58% of Net Premiums Written in 1998 to 2.5% in 1999. In 1996, the IBNR had been as high as 10.9%. The reduction of the 1999 IBNR reserve resulted in a reserve deficiency in the year 2000's reserve development. (Annual Statement, page 72, Schedule P, Part 2) In order to prevent a reoccurrence of this problem, it is recommended the Company's independent, external actuary review the year-end IBNR computation before it is finalized.
6. **Conflict of Interest** – Two members of the Board of Trustees provide outside services to the Company. One acts as an insurance agent and the other serves as an officer in a securities brokerage firm which is the custodian of the Company's stock investments. The latter is both officer and member of the Board of Trustees of the Company. Although the Board of Trustees determined that no conflict of interest existed it is recommended that the Company obtain a waiver from the Washington Office of the Insurance Commissioner in order to determine that, in fact, there is compliance with RCW 48.07.130. (See page 7, "Conflict of Interest")

HISTORY

Mutual of Enumclaw Insurance Company was originally incorporated in February 1898 under the laws of Washington. The Company was then reincorporated August 11, 1899 under the Mutual Insurance Law of 1899, which allowed incorporation under an assessment plan. The Company was organized by, and was to be run for the benefit of its policyholder members with the purpose of insuring farm and village buildings and personal property against loss by fire and lightning.

The first change to the original Articles of Incorporation in 1943 broadened the definition of property risks covered to reflect a more urban living environment. Changes continued periodically with current Certificates of Authority allowing for property, casualty, surety, marine and transportation business.

In 1948, the assessment liability feature was removed from its policies and the advance premium plan was instituted as allowed by RCW 48.09.270. The Company has continued to maintain the minimum surplus required by this law to write non-assessable policies.

In 1952, the Company obtained Certificates of Authority to transact business in the states of Idaho and Oregon. Twice (in 1953 and 1963), the Company expanded its business through assumption of business appropriate to its purpose.

The Company name was changed to Mutual of Enumclaw Insurance Company in 1966 by amendment to Article II of the Articles of Incorporation. On June 30, 1994, the Company sold its wholly owned subsidiary, Enumclaw Life Insurance Company.

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MANAGEMENT AND CONTROL

The Company's affairs are conducted under the direction of experienced insurance executives. President Gerald P. Schmidt, who was named General Manager in September 1993 and President in July 1995, heads the official staff.

Board of Trustees

Article II, Section 1 of the Corporate Bylaws authorizes not less than seven and not more than eleven trustees with whom all matters concerning the management of the Company is vested. Three are to be elected in January at each annual meeting of members for a three-year term. This effectively staggers the election of new trustees over a period of three years, which accomplishes consistency on the Board of Trustees (BOT) in matters of administration.

Trustees currently serving the Company at December 31, 1999 were:

<u>Name/Address</u>	<u>Position(s)/Principal Affiliations</u>	<u>BOT Since</u>
Dwight Leon Cummins Silverton, Oregon	Business Development Manager, Western Bank	1993
Bernadene Dochnahl Renton, Washington	Owner, Denbe Enterprises	1988
Vance Oswald Fredrickson Enumclaw, Washington	Chairman of the Board, Mutual of Enumclaw	1970
Robert Christopher Guile Federal Way, Washington	Risk Manager, Tacoma School District	1992
Peter Charles Hanson Seattle, Washington	Vice President, Mutual of Enumclaw Executive VP, Ragen-Mackenzie, Inv. Bankers	1984
Gary Phillip Heer Salem, Oregon	Owner, Antique Boutique	1993
Gerald Paul Schmidt Auburn, Washington	President, Mutual of Enumclaw	1995
Fredrick Merton Schunter Spokane, Washington	President, Inland Northwest Bank Director, Spokane Capital Management Corporation Director, Business Development Corp. of Eastern, Washington	1992
David Merle Waldo Nyssa, Oregon	President, Field-Waldo Ins. Agency	1994

Officers

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Article II, Section 4 of the Bylaws provides that the officers of the Company shall be chosen by the Board of Trustees from their number and they shall be Chairman of the Board, President, and a Vice President. They may also choose other such officers as they deem necessary and proper for the administration of the business of the Company. The Chairman of the Board shall act as Chairman at all meetings.

Officers on December 31, 1999 were:

<u>Name</u>	<u>Position</u>
Vance Oswald Fredrickson	Chairman
Gerald Paul Schmidt	President
Peter Charles Hanson	Vice President
Lawrence Ronald Edlund	Vice President Finance and Treasurer
John Raymond Engel	Vice President Claims
David John Stojanovich	Vice President, Personal Lines
Matthew Louis Picinich	Vice President, Information Systems
Donald Leedy Cutler	Vice President, Comm. Lines
Bernadene Dochnahl	Secretary
John Robert Willis	Vice President, Marketing

Committees

Article II, Section 5 of the Bylaws provides that the Board of Trustees may establish an Executive Committee and vest therein such powers, as the Board deems proper.

The Board of Trustees has also authorized two other committees; the Investment Committee and the Compensation Committee.

The following persons were appointed to the named committees and were serving at December 31, 1999 for a one year term expiring at the next annual meeting:

<u>Executive Committee</u>	<u>Investment Committee</u>
Vance Oswald Fredrickson	Vance Oswald Fredrickson
Peter Charles Hanson	Peter Charles Hanson
Frederick Merton Schunter	Dwight Leon Cummins
Bernadene Dochnahl	Fredrick Merton Schunter
Gerald Paul Schmidt	Larry Ronald Edlund
	Gerald Paul Schmidt

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Compensation Committee

Bernadene Dochnahl
Robert Christopher Guile
Gary Philip Heer
Frederick Merton Schunter
David Merle Waldo

Corporate Records

Generally, Board of Trustee's meetings are held every other month on the odd months. The Executive Committee meets as often as deemed necessary.

The Investment Committee meets in March and November and as needed. The Compensation Committee meets annually in August of each year to consider employee compensation recommendations prepared by an outside consulting firm.

The review of the minutes of the Board of Trustees, the Investment Committee, the Executive Committee, the Compensation Committee, and the Annual Policyholder Members Meeting indicated that all meetings were well attended. The minutes were in sufficient detail and substance to demonstrate that the Board was actively involved in the administration of the affairs of the Company.

Conflict of Interest

The Company annually requires all Trustees, Officers and other responsible employees which includes auditors, accounting personnel, claims representatives, purchasing agents, heads of departments and any employee having draft authority, to complete the disclosure of a "conflict of interest" statement.

The procedure includes reading the two Washington State Statutes, RCW 48.07.130, and RCW 48.13.350, and returning a signed Statement of Disclosure to the Company.

The Company has been diligent in its completion of this procedure and documentation is well maintained. However, two members of the Company's Board of Trustees provide services to the Company. One as an insurance agent and the other serving a dual role as an officer and member of the Board of Trustees of the Company and also is serving as an officer of the securities brokerage firm which is the custodian of the Company's stock investments. Although the Board of Trustees determined that no conflict of interest existed, it is recommended that the Company obtain a waiver from the Washington Office of the Insurance Commissioner in order to determine that, in fact, there is compliance with the above statutes. (See Page 4, "Comments and Recommendations")

INTERNAL SECURITY

Fidelity Bond and Other Insurance

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The Company is a named insured on a financial institution fidelity bond in the amount of \$1,000,000 with an authorized insurance carrier. However, the coverage does not meet the \$1,250,000 minimum amount suggested by the National Association of Insurance Commissioners. It is suggested that the Company increase its current financial institution bond (fidelity bond) from \$1,000,000 to \$1,250,000. The following is a summary of the coverage provided by the policy.

Employee Dishonesty	\$1,000,000	\$10,000
Forgery or Alteration	\$1,000,000	\$10,000
Securities	\$1,000,000	\$10,000
Computer Systems Rider	\$1,000,000	\$10,000

The Company is also a named insured on a Directors and Officers Liability Policy with an authorized insurance carrier. The limit of liability (inclusive of defense expenses) is \$5,000,000 with a per claim deductible of \$300,000.

The Company's Retirement Plan and Salary Investment Plan also carry \$1,000,000 Employee Dishonesty Coverage with an authorized insurance carrier.

The Company also carries Special Multi-Peril and automobile liability coverages. Property and equipment coverages appear to be adequate per the policy coverages, limits, and schedules reviewed. Errors and Omissions coverage is not provided under any policy.

Internal Controls

The CPA firm of Ernst & Young was retained by the Company to audit its statutory financial statements. Reports for 1998 and 1999 were provided as well as the work papers for 1999. As part of the audit work papers, the internal control structure was noted as having no material weaknesses. The examiners' further review of the Company's internal controls revealed no material weaknesses.

Electronic Data Processing System

The examiners' review of data processing controls disclosed no material weaknesses. LAN management software installed on the network has continued to provide adequate control. Control procedures also include back up of LAN files along with mainframe data and program files that are then sent to the Company's offsite storage facility on a daily basis. Recovery of the LAN and mainframe operations is the main focus of the Company's overall recovery plan to resume business activities as quickly as possible if a disaster occurs. The disaster recovery plan includes a recovery hot site for the LAN/Mainframe operations and a cold site for resumption of business activities. Annual testing of the Company's ability to recover has been conducted.

Contracts

As of December 31, 1999, the Company was party to the following contracts:

With Non-Affiliates:

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Banking Custodial Agreements - The Company has two securities custodial agreements with two commercial banks.

Leases - The Company was obligated under non-cancelable leases expiring through 1999 for office space and equipment totaling \$1,712,961.

Other Agreements

The Company utilizes the services of Bank of New York as trustee to hold its bond investments. Examination of the custodial agreement indicates that proper safeguards are in place to secure the Company assets for the type of investments held. However, the agreement did not contain the language recommended by NAIC standards that requires: "The bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody occasioned by the negligence or dishonesty of the bank or trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction."

"That in the event of a loss of the securities for which the bank or trust company is obligated to indemnify the insurance company, the securities and the value of any loss or rights or privileges resulting from said loss of securities shall be promptly replaced." The Company must amend the custodial agreement with Bank of New York Western Trust Company and Ragen MacKenzie Incorporated to include the language described above and in compliance with WAC 284-07-050(2). (See Instruction #1, page 3)

The Company's preferred stock investments held by Ragen MacKenzie is not in compliance with the NAIC standard and WAC 284-07-050(2) requiring securities to be held in the custody of a bank, trust company, or security depository. The Company must move the securities to a new custodian and execute a safekeeping agreement that meets the applicable requirements.

EMPLOYEES' BENEFIT PLANS

Retirement and Deferred Compensation

The Company's Retirement Plan is a contributory defined benefit plan covering employees aged 21 and older who work 1,000 hours or more per year. The current plan was originally established in 1967 and has been modified periodically to comply with changes in Federal Regulations. Pension costs are funded as they accrue and vested benefits are fully funded. The plan administrator is the Board of Trustees of the Company with an established commercial bank appointed as Trustee.

A supplement executive Retirement Plan was approved on September 27, 1999 with an effective date of April 1, 1999, and is intended as an unfunded plan to be maintained for the purpose of providing supplemental retirement income to a select group of management personnel and highly compensated employees. As such, it is intended that the Plan be exempt from Parts 2 through 4 of Subtitle B of Title 1 of the Employee Retirement Income Security Act of 1974, as amended.

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In 1987, the Company provided employees the opportunity to participate in a Non-Contributory 401 (K) Program.

All eligible employees who are members of the Company's Retirement Plan are eligible for a company-funded Retirement Life Insurance Plan which is a term policy granting death benefits of 61 times the normal monthly retirement income.

Health Care Program

The Company offers several options to its Employees and dependents for Medical, Dental and Vision Care benefit coverages under a Federally regulated "Cafeteria Plan", through selected Health Care Contractor's and HMO's. The Company pays for the employees and the employees pay for their dependents.

Long Term Disability

Insurance benefits for replacement of income lost due to an employee's disability are available through the Company at no cost to the employee.

TERRITORY AND PLAN OF OPERATIONS

Mutual of Enumclaw Insurance Company has Certificates of Authority to transact business in the states of Idaho, Oregon, Utah, and Washington. Classes of insurance authorized include Property, Casualty (excluding Workers Compensation), Marine & Transportation and Surety. Premium Tax receipts indicated that the required fees had been paid to each state and the Company's Certificate of Authority for each state was in effect. The Company's agents are properly licensed and appointed.

GROWTH OF COMPANY

The growth of the Company is reflected in the following schedule compiled from its annual statements as of 12/31:

<u>Year</u>	<u>Net Premiums</u> <u>Written</u>	<u>Net Losses</u> <u>Paid</u>	<u>Admitted</u> <u>Assets</u>	<u>Surplus as Regards</u> <u>Policyholders</u>
1995	\$ 183,479,754	\$ 110,572,417	\$ 311,364,338	\$ 106,962,346
1996	189,557,151	125,037,739	318,403,616	106,190,359
1997	206,088,105	136,013,307	324,759,807	112,671,843
1998	223,384,145	131,116,884	346,395,719	123,819,429
1999	231,825,153	145,159,842	353,943,186	128,103,656

REINSURANCE

The Company protects itself from excessive losses by reinsuring on a treaty and facultative basis. The Company remains obligated for amounts ceded in the event that reinsurers are unable to meet their obligations.

The Company has entered into an agreement with a licensed reinsurance intermediary-broker in connection with the placement or reinsurance relating to the Company's insurance business. The

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agreement with the reinsurance intermediary-broker does contain the required provisions of the Chapter 48.94 RCW. Also, all authorized non-United States insurers and all unauthorized reinsurers maintain statutory compliant letters of credit for the benefit of the Company in adequate amounts. The treaties include the insolvency clause in compliance with RCW 48.12.160 (3).

Comprehensive Excess of Loss

- A. Casualty Business including Umbrella,
\$ 4,500,000 excess \$ 500,000 each Loss Occurrence.
- B. Property Business,
\$ 2,500,000 excess \$ 500,000 each Risk subject to an Occurrence Limit of \$ 5,000,000

Second Casualty Excess of Loss

\$ 5,000,000 excess \$ 5,000,000 each Loss Occurrence.

Personal and Commercial Umbrella Excess

With respect to each Policy ceded to this Agreement, \$ 4,000,000 excess \$ 1,000,000 each Loss Occurrence, each Policy, on Personal and Commercial Umbrella.

Property Catastrophe Excess of Loss

- 1st 95% of \$ 5,000,000 excess \$ 5,000,000 each Loss Occurrence.
- 2nd (a) 90% of \$75,000,000 excess \$10,000,000 each Loss Occurrence. (19.25% share)
- 2nd (b) 90% of \$75,000,000 excess \$10,000,000 each Loss Occurrence. (80.75% share)
- 3rd 90% of \$25,000,000 excess \$85,000,000 each Loss Occurrence.

Boiler and Machinery

100% of \$25,000,000 excess of \$0 (Company cedes all of this business)

ACCOUNTING RECORDS AND SYSTEMS

With the exception of the comments below, the Company maintains well-controlled accounting records and systems. The Company is currently using IBM-compatible hardware and software. All of its applications are IBM compatible. Some of its data, however, remain from a Honeywell legacy system. The Company has to simulate the Honeywell environment on the IBM system in order to maintain this data.

The examination disclosed the following opportunities for improvement in the maintenance of accounts and records:

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1. Unallocated Income – In order to recognize cash receipts that could not be offset to the applicable accounts receivable sub-accounts for financial statement purposes, the Company makes a monthly adjusting entry to record a liability for “Unallocated Income”. Since cash has already been recorded by reducing the accounts receivable control account, the adjusting entry restores the receivable to its original balance in order to set up the presumed liability. Consequently, the inadvertent effect is to duplicate the asset recognition by the amount of the cash receipts. Although this practice has no surplus change, and since system constraints preclude any alternative correction, the optimal solution would be to cease making this entry until the system is enhanced. It is recommended that Company’s automated systems and software be updated and integrated to provide accurate and appropriate accounting entries to meet statutory reporting requirements. (See “Comments and Recommendations” #1, Page 3)
2. Other Expenses – In the prior examination, a comment was made to the Company that the methodology for accruing “Other Expenses” was inadequate and that management was advised to improve it. During this examination, the examiners found that the methodology was not changed and the resulting under-accrual for 1999 was \$177,210. It is recommended that the Company improve its accrual methodology and that disbursements subsequent to year-end be monitored for as long as possible and expenditures relating to the prior year be identified for accrual in the final closing trial balance. (See “Comments and Recommendations” #2, Page 3)
3. Drafts Outstanding – The Company has improperly classified its outstanding checks as of December 31, 1999 as outstanding drafts. While there is no effect on the Company’s surplus, it is recommended that the Company reclassify these outstanding checks as a reduction of cash accounts. During the examination, it was noted that the Company did reclassify the outstanding checks as a reduction to cash in its 2000 Annual Statement. (See “Comments and Recommendations” #3, Page 3)
4. Salvage and Subrogation – The examination testing of “Salvage and Subrogation” revealed that recoveries on homeowners’ policy losses were incorrectly classified to another line of business, probably to an auto policy. Although the amount involved was immaterial for examination purposes, it does distort the loss development data used for statutory and management reporting purposes and the examiners recommended that it should be corrected. (See “Comments and Recommendations” #4, Page 3)
5. IBNR – In order to match the industry’s loss experience and prevailing IBNR accrual practices, the Company reduced its IBNR reserve from 3.58% of Net Premiums Written in 1998 to 2.5% in 1999. It was noted that in 1996, the IBNR had been as high as 10.9%. The reduction of the 1999 IBNR reserve resulted in a reserve deficiency in the year 2000’s reserve development. (Annual Statement, page 72, Schedule P, Part 2) In order to prevent a reoccurrence of this problem, it is recommended the Company’s independent, external actuary review the year-end IBNR computation before it is finalized. (See “Comments and Recommendations” #5, Page 4)

The actuarial staff of the Washington Office of the Insurance Commissioner reviewed the reserves of the Company’s unpaid loss and loss adjustment expenses. The OIC’s actuarial staff’s estimates of these liabilities, on a net basis, are within a reasonable range. Therefore, these reserves are accepted as they appear in the Company’s 1999 Annual Statement.

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SUBSEQUENT EVENTS

There are no events or pending transactions that occurred after December 31, 1999 that would have a material effect on the financial statements.

FINANCIAL STATEMENTS

The following statements reflect the financial condition of the Company as of December 31, 1999, as determined by this examination:

Balance Sheet
As of December 31, 1999

Comparative Balance Sheet
As of December 31, 1998 and 1999

Statement of Income
Year Ended December 31, 1999

Comparative Statement of Income
For the Years Ended December 31, 1998 and 1999

Capital and Surplus Account
As of December 31, 1999

Comparative Capital and Surplus Account
Years Ended December 31, 1995 through 1999

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Balance Sheet As of December 31, 1999

	BALANCE PER COMPANY	Notes	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION
ASSETS				
Bonds	\$231,792,891	1		\$231,792,891
Stocks:				
Preferred	26,537,430	2		26,537,430
Common	18,854,393	3		18,854,393
Real estate:				
Properties occupied by the company	5,738,575	4		5,738,575
Cash and short-term investments	22,906,752			22,906,752
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	41,385,266	5		41,385,266
Reinsurance recoverable on loss and lae	300,952			300,952
Federal income tax recoverable	66,900	6		66,900
Electronic data processing equipment	1,491,425			1,491,425
Interest, dividends and real estate income due and accrued	4,868,602			4,868,602
Amounts receivable relating to uninsured A&H plans				
Aggregate write-ins for other than invested assets				
Total assets	<u>\$353,943,186</u>			<u>\$353,943,186</u>
LIABILITIES				
Losses	\$95,668,931	7		\$95,668,931
Loss adjustment expenses	20,983,000	7		20,983,000
Contingent commissions and other charges	1,780,000	8		1,780,000
Other expenses (excl. taxes, licenses & fees)	143,079	9		143,079
Taxes, licenses & fees (excl. fed. inc. tax)	399,626	10		399,626
Unearned premiums	92,249,551			92,249,551
Amounts withheld by company for others	4,776			4,776
Excess of statement reserves over statement reserves	4,769,000			4,769,000
Drafts outstanding	6,237,003	11		6,237,003
Aggregate write-ins for liabilities	3,604,565	12		3,604,565
Total liabilities	<u>225,839,531</u>			<u>225,839,531</u>
<u>SURPLUS AND OTHER FUNDS:</u>				
Common capital stock				0
Preferred capital stock				0
Gross paid in and contributed surplus				0
Unassigned funds (surplus)	<u>128,103,656</u>			<u>128,103,656</u>
Surplus as regards policyholders	<u>128,103,656</u>			<u>128,103,656</u>
Total liabilities, surplus and other funds	<u>\$353,943,187</u>			<u>\$353,943,187</u>

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Comparative Balance Sheet As of December 31,

<u>ASSETS</u>		
	<u>1999</u>	<u>1998</u>
Bonds	\$ 231,792,891	\$ 241,911,587
Stocks:		
Preferred	26,537,430	22,271,028
Common	18,854,393	12,554,903
Properties occupied by the company	5,738,575	5,834,045
Cash and short-term investments	22,906,752	18,398,742
Agents' balances or uncollected premiums	41,385,266	39,317,942
Reinsurance recoverable on loss and lae	300,952	103,092
Federal income tax recoverable	66,900	0
Electronic data processing equipment	1,491,425	1,105,343
Interest, dividends and real estate income due and accrued	4,868,602	4,842,236
Guaranty funds receivable or on deposit	0	11,801
	<hr/>	<hr/>
Total assets	<u>\$ 353,943,186</u>	<u>\$ 346,350,719</u>
 <u>LIABILITIES</u>		
Losses	\$ 95,668,931	\$ 97,184,568
Loss adjustment expenses	20,983,000	21,378,000
Contingent commissions and other charges	1,780,000	1,193,500
Other expenses (excl. taxes, licenses & fees)	143,079	938,697
Taxes, licenses & fees (excl. fed. inc. tax)	399,626	876,700
Fed and foreign inc. taxes (excl. def. taxes)	0	159,300
Unearned premiums	92,249,551	88,712,357
Amounts withheld by company for others	4,776	7,231
Excess of stat. reserves over stmt. reserves	4,769,000	3,925,000
Drafts outstanding	6,237,003	4,919,764
Provision for reinsurance	0	20,618
Aggregate write-ins for liabilities	3,604,565	3,260,556
	<hr/>	<hr/>
Total liabilities	<u>225,839,531</u>	<u>222,576,291</u>
 <u>SURPLUS AND OTHER FUNDS</u>		
Unassigned funds (surplus)	128,103,656	123,819,429
Surplus as regards policyholders	128,103,656	123,819,429
Total liabilities, surplus and other funds	<u>\$ 353,943,187</u>	<u>\$ 346,395,720</u>

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Statement of Income As of December 31, 1999

	Balance Per Company	Balance Per Examination
<u>UNDERWRITING INCOME</u>		
Premiums earned	<u>\$ 228,287,959</u>	<u>\$ 228,287,959</u>
DEDUCTIONS:		
Losses incurred	143,644,202	143,644,202
Loss expenses incurred	21,696,371	21,696,371
Other underwriting expenses incurred	<u>74,886,682</u>	<u>74,886,682</u>
Total underwriting deductions	<u>240,227,255</u>	<u>240,227,255</u>
Net underwriting gain or (loss)	<u>(11,939,296)</u>	<u>(11,939,296)</u>
<u>INVESTMENT INCOME:</u>		
Net investment income earned	20,864,119	20,864,119
Net realized capital gains or (losses)	<u>552,969</u>	<u>552,969</u>
Net investment income gain or (loss)	<u>21,417,088</u>	<u>21,417,088</u>
<u>OTHER INCOME</u>		
Finance and service charges not included in premiums	2,453,735	2,453,735
Aggregate write-ins for miscellaneous income	<u>(320,602)</u>	<u>(320,602)</u>
Total other income	<u>2,133,133</u>	<u>2,133,133</u>
Net income before dividends to policyholders and before federal and foreign income taxes	<u>11,610,925</u>	<u>11,610,925</u>
Net income before fed. and foreign income taxes	11,610,925	11,610,925
Federal and foreign income taxes incurred	<u>3,135,189</u>	<u>3,135,189</u>
Net income	<u>\$ 8,475,736</u>	<u>\$ 8,475,736</u>

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Capital and Surplus Account As of December 31, 1999

	Balance <u>Per Company</u>	Balance Per <u>Examination</u>
Surplus as regards policyholders, December 31, previous year	\$ 123,819,429	\$ 123,819,429
<u>GAINS AND (LOSSES) IN SURPLUS</u>		
Net income	8,475,736	8,475,736
Net unrealized capital gains or (losses)	(2,298,644)	(2,298,644)
Change in non-admitted assets	(973,410)	(973,410)
Change in liabilities for reinsurance	20,618	20,618
Change in excess of statutory reserves over statement reserves	(844,000)	(844,000)
Aggregate write-ins for gains and losses in surplus	(96,073)	(96,073)
Changes in surplus as regards policyholders for the year	4,284,227	4,284,227
Surplus as regards policyholders, December 31, current year	<u>\$ 128,103,656</u>	<u>\$ 128,103,656</u>

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Comparative Statement of Income As of December 31,

	<u>1999</u>	<u>1998</u>
<u>UNDERWRITING INCOME</u>		
Premiums earned	<u>\$ 228,287,959</u>	<u>\$ 217,120,230</u>
DEDUCTIONS:		
Losses incurred	143,644,202	133,601,124
Loss expenses incurred	21,696,371	19,733,759
Other underwriting expenses incurred	<u>74,886,682</u>	<u>72,238,519</u>
Total underwriting deductions	<u>240,227,255</u>	<u>225,573,402</u>
Net underwriting gain or (loss)	<u>(11,939,296)</u>	<u>(8,453,172)</u>
<u>INVESTMENT INCOME:</u>		
Net investment income earned	20,864,119	20,834,730
Net realized capital gains or (losses)	<u>552,969</u>	<u>209,926</u>
Net investment income gain or (loss)	<u>21,417,088</u>	<u>21,044,656</u>
<u>OTHER INCOME</u>		
Finance and service charges not included in premiums	2,453,735	2,431,639
Aggregate write-ins for miscellaneous income	<u>(320,602)</u>	<u>(203,183)</u>
Total other income	<u>2,133,133</u>	<u>2,228,456</u>
Net income before dividends to policyholders and before federal and foreign income taxes	<u>11,610,925</u>	<u>14,819,940</u>
Net income before fed. and foreign income taxes	11,610,925	14,819,940
Federal and foreign income taxes incurred	<u>3,135,189</u>	<u>4,954,300</u>
Net income	<u><u>\$ 8,475,736</u></u>	<u><u>\$ 9,865,640</u></u>

MUTUAL OF ENUMCLAW INSURANCE COMPANY

Comparative Capital and Surplus Account As of December 31,

	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>
Surplus as regards policyholders, December 31, previous year	\$ <u>123,819,429</u>	\$ <u>112,671,843</u>	\$ <u>106,190,843</u>	\$ <u>106,962,346</u>	\$ <u>107,539,390</u>
GAINS AND (LOSSES) IN SURPLUS:					
Net Income	8,475,736	9,865,640	5,652,698	1,442,999	(1,420,129)
Net unrealized capital gains or (losses)	(2,298,644)	1,424,933	757,038	39,197	203,185
Change in non-admitted assets	(973,410)	16,341	(179,028)	57,428	(6,507)
Change in liability for reinsurance	20,618	408,382	(383,000)	25,000	(21,000)
Change in excess of statutory reserves over statement reserves	(844,000)	(496,000)	690,000	2,264,000	1,225,000
Aggregate write-ins for gains and losses in surplus	(96,073)	(71,710)	(56,224)	(2,261)	(557,593)
Changes in surplus as regards policyholders for the year	<u>4,284,227</u>	<u>11,147,586</u>	<u>6,481,484</u>	<u>3,826,363</u>	<u>(577,044)</u>
Surplus as regards policyholders, December 31, current year	\$ <u><u>128,103,656</u></u>	\$ <u><u>123,819,429</u></u>	\$ <u><u>112,672,327</u></u>	\$ <u><u>110,788,709</u></u>	\$ <u><u>106,962,346</u></u>

MUTUAL OF ENUMCLAW INSURANCE COMPANY

NOTES AND COMMENTS TO FINANCIAL STATEMENTS

1. Bonds

Bonds were reported in the Annual Statement in accordance with NAIC valuation rules, which is at amortized cost. Discount or premium on bonds is amortized using the effective yield method. The NAIC admitted bond value was \$239,716,080 and market value was \$231,831,830. Market value is determined by the NAIC's Security Valuation Office. Accrued interest on bonds at December 31, 1999, was \$4,914,336.

One bond was not filed with the Securities Valuation Office of the NAIC. The Company did not list on Schedule D, Part 4 and 5 of the 1999 Annual Statement the Name of Purchaser on Securities Sold. The Company did not use the trade date for the date of Purchase or Disposal of securities. The Company is instructed to file all securities as required by the NAIC and pursuant to WAC 284-07-050(2), and to ensure proper reporting in accordance with RCW 48.05.250.. (See Instruction #1, Page 2.)

The Company's custodial agreement did not meet the standards established by the NAIC. The Company is instructed to amend the custodial agreement to include the standard as required by the NAIC and in compliance with WAC 284-07-050(2). (See Instruction #1, Page 2)

2. Preferred stocks

The Company valued two preferred stocks at the wrong market value. An adjustment was made to correct this error. It was noted that a brokerage firm of Ragen MacKenzie held the preferred stocks of the Company, which is not in compliance with the NAIC standard requiring securities to be held in the custody of a bank, trust company, or security depository. It is instructed that the Company move the securities to a custodian that is permitted under WAC 284-07-050(2). The Company also should execute a custodial agreement that meets the standards established by the Washington Office of the Insurance Commissioner in RCW 48.13.460, effective July 2000. It is also required that the Company notify the OIC when and where the securities will be moved, and submit a copy of the new custodial agreement. (See Instruction #2, Page 2)

3. Common stocks

The Company used the wrong market value for one stock and another issue with mathematical error. An adjustment was made to correct this error. The Company's Safekeeping Agreement did not meet the minimum standard established by the NAIC concerning the custodian's indemnification of the insurance company for any loss of securities in the custodian's possession. The Company is instructed to amend the agreement to adopt the language as recommended by the NAIC. It is also noted that a brokerage department in the US Bank of Oregon held two issues of common stocks at year-end. This practice is not in compliance with the NAIC standard requiring securities to be held in the custody of a bank, trust company, or security depository. It is instructed that the Company move the securities to a custodian that is permitted under WAC 284-07-050(2). (See Instruction #3, Page 2)

4. Real estate

MUTUAL OF ENUMCLAW INSURANCE COMPANY

The only property listed by the Company on its Annual Statement is the home office. The property is held free and clear of any debt. The Company appears to be accounting for expense and improvements in a consistent manner in conformity with the accounting practices prescribed by Chapter 48.13 RCW.

5. Uncollected premiums

The Company was not able to provide a detail list of premiums due as of December 31, 1999 by policyholder. It is recommended that the Company develop a program to summarize the accounts receivable by policyholder that will tie in to the general ledger. The Company reduces premiums and agents' balances in the course of collection by the amounts received from reinsurers for claims that have not been settled. The Company requests payments from reinsurers on large claims that will take an extended period of time to settle. In addition, the Company as part of its closing procedure debits accounts receivable for the amount in pending cash and credits a write in liability account called "unallocated income". This practice overstates uncollected premiums and unallocated income. (See "Comments and Recommendations" #1, Page 3)

6. Federal income tax recoverable

The asset shown in the balance sheet as of December 31, 1999 was less than the amount shown in the filed tax return. The Company's certain tax expenses were estimated in the annual statement that was recognized when the tax return was filed. The Company received a tax refund of \$62,825 after paying a penalty for not making the estimated tax payments on time which was \$4,075 less than the asset established at year-end. The amount indicated is immaterial for examination purposes.

7. Losses and loss adjustment expenses

The reserves carried by the Company for these liabilities were \$95,668,931 and \$20,983,000, respectively, as of December 31, 1999.

The casualty actuarial staff employed by the Washington Office of the Insurance Commissioner reviewed these reserves. The Company's consulting actuarial firm, Ernst & Young, provided loss and loss adjustment expense development data by line of business. The Washington OIC actuarial staff obtained additional information by interviewing several Company employees. The actuarial report prepared by Ernst & Young was also reviewed as part of this examination.

The Washington OIC actuarial staff's estimates indicate that reserves for both losses and loss adjustment expenses, on a net basis, are within a reasonable range. Therefore, these reserves are accepted as they appear in the Company's 1999 Annual Statement.

MUTUAL OF ENUMCLAW INSURANCE COMPANY

8. Contingent commissions

This amount represents an accrual for the 1999 profit bonuses paid to agents during 2000. The Company overstated the accrual by \$85,331. The overstatement is immaterial, therefore, no adjustment is recommended.

9. Other expenses

In the prior examination workpapers, it was mentioned that the Company's practice of accruing a flat \$100,000 annually for other expenses was inadequate and that management was advised to improve it. Since then, the practice has not changed and the other expenses were understated by \$177,210 at year-end. The amount is immaterial, therefore, no adjustment is recommended. (See "Comments and Recommendations" # 2, Page 3)

10. Taxes, licenses and fees

It was noted in the review of the 1999 premium tax returns that there was an error in the Oregon tax computation. This error occurred because another employee other than the preparer did not review the returns. It is recommended that a pre-filing review procedure be instituted. The 1999 accrual of taxes, licenses and fees were understated in the amount of \$180,800. The amount is immaterial, therefore, no adjustment is recommended.

11. Drafts outstanding

The Company has improperly classified its outstanding checks as of December 31, 1999 as outstanding drafts. While there is no effect in the Company's surplus, it is recommended that the Company reclassify these outstanding checks as a reduction of its cash accounts. During the examination, it was noted that the Company did reclassify the checks as reductions to cash in its 2000 Annual Statement. (See "Comments and Recommendations" # 3, Page 3)

12. Aggregate write-ins for liabilities

For financial statement preparation purposes, a monthly adjusting entry is made to record a liability for unallocated income, recognizing cash receipts which could not yet be offset against the appropriate accounts receivable subaccounts. Since cash was already recorded by reducing the accounts receivable control account, the adjusting entry restores the receivable to its original balance in order to set up the presumed liability. Consequently, the inadvertent effect is to duplicate the asset recognition by the amount of the cash receipts. Although this practice has no effect to surplus, and since system constraints preclude any alternative correction, the optimal solution would be to cease making this entry until the system is enhanced.

MUTUAL OF ENUMCLAW INSURANCE COMPANY

ACKNOWLEDGMENT

The cooperation extended to the examiners by the officers and employees of the Company during the course of this examination is hereby acknowledged.

In addition to the undersigned, John J. Gaynard, CPA, CPCU, Examiner, John Jacobson, AFE, Information Systems Examiner, Eric Slavich, Actuarial Analyst 2, and D. Lee Barclay, FCAS, MAAA, Supervising Actuary, all from the state of Washington, and Richard Randour, CPA, CFE from the state of Utah, participated in the examination and preparation of this report.

Respectfully submitted,

Timoteo L. Navaja, CFE, CIE
Examiner-in-Charge
Office of Insurance Commissioner
Washington State

Larry E. Cross, CFE, CIE
Supervising Insurance Examiner
Representing Utah
and NAIC Western Zone

MUTUAL OF ENUMCLAW INSURANCE COMPANY

State of Washington)
) ss
County of Thurston)

Timoteo L. Navaja, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

Timoteo L. Navaja, CFE, CIE
Examiner in Charge

Subscribed and sworn to before me on this _____ day of _____, 2001.

Notary Public in and for the
state of Washington.